CHAPTER I

INTRODUCTORY

I. Definition of Public Finance.

II. Importance of Public Finance in Modern Times.

III. Divisions of Public Finance.

IV. Fundamental Principle of Public Finance: Maximum Social Advantage.

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CHAPTER I

INTRODUCTORY

I. Definition of Public Finance:-

Hitherto we have been dealing with the financial activities of individuals or groups of individuals, and have considered those of the state only in so far as they react upon private enterprise. Thus, in dealing with the money market, we saw how Government operations in Treasury bills have modified its functioning in modern times. We have now to examine more closely the nature of the financial operations of the State - the manner in which it raises its income and how it spends it - since these questions have now come to occupy a vital part in modern economic life. In Great Britain, for example, where the Budget expenditure exceeds £ 700,000,000/- of which more than one-third is attributable to interest on debt, the importance of the subject of public finance needs no emphasis.

We may consider the State as an institution which has developed on account of the necessity for collective action in the satisfaction of certain human wants. It consequently has certain elements in common with other economic units constituted for a similar purpose, though in more restricted fields of activity, such as the family, churches, clubs and other associations. It resembles in

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many respects the private household, although it preserves its peculiar character by reason of the fact that its field of activity is far wider than that of the household, and it has control of resources which are not accessible to the private individual. Whilst, in the household of the individual, the acquisition of revenue determines the scale of expenditure, in the case of the State, the magnitude of the expenditure will largely determine the revenue. Again, the perpetual nature of the State as an economic unit throws a heavy burden of responsibility upon those entrusted with the administration of the public finances, for they must adopt a course which will not only satisfy current requirements, but which will also not impose an unfair burden upon future generations. It is to be feared that modern finance ministers have paid far too little attention to this aspect of their duties. They have looked to the immediate need of the moment, and have been inclined to let the future take care of itself.

Public finance is that branch of economics which deals with the revenues and expenditures of governments and with the administration of such revenues and expenditures.

Carl Plehn defines public finance as "the science which deals with the activity of the statesman in obtaining and applying the material means necessary for fulfilling the proper functions of the state". The expenditures of

the state are for performing the state functions, and to meet these expenditures the state has to raise revenues and to administer them.

II. Importance of Public Finance in Modern Times:-

1) The total amount of public expenditures at the present time is of enormous dimensions and an enormous aggregate of public revenues has to be raised every year to defray these expenditures.

2) Not only the total of public expenditures is very large, it is increasing and it is increasing at a very rapid rate. The gradual expansion of public expenditures is being brought about by the expansion in the functions of modern governments. A modern government performs many duties in connection with the poor and unfortunate, in connection with sanitation, education and public works etc., which were not undertaken by governments of earlier periods.

Government business is the largest single business in every advanced modern state. The total expenditures and revenues of a government every year are much larger than the revenues and expenditures of the richest multi-millionaire within the state. The government is the largest employer of labour within the country and so influences greatly rates of wages and conditions of employment for labour. And government business is not only vast in its extent, the influence

(direct and indirect) that the government revenues and expenditures exercise upon the production, distribution and consumption of wealth is enormous.

3) The war has enormously increased national expenditures and has multiplied many times national debts - the English national debt during the war has increased from about 600 million to about 8,000 million, more than ten times, and similar increases have taken place in other countries.

For all these reasons a study of the activity of the state, its revenues and expenditures, is of great importance.

III. Divisions of Public Finance:-

The subject of public finance has four principal divisions:-

1) Public Expenditures
2) Public Revenues
3) Public Debts
4) Financial Administration.

IV. Fundamental Principle of Public Finance: Maximum Social Advantage:-

The fundamental principle of Public Finance (as indeed of all Economics and Political Science) is the principle of general welfare - the principle of the greatest social good for the community - the principle of maximum social advantage.

All public expenditures are to be judged from the standpoint of this principle. All the revenues (taxes and other revenues) which the state raises to meet its public expenditure are to be examined from this standpoint. Whether a tax is good or bad, whether the tax system in a country is satisfactory or otherwise can be known by examining the burden of the tax and also how the tax revenue is spent, and whether on the whole considering the immediate and ultimate effects the general welfare has been promoted.

Dr. Dalton explains the Principle of Maximum Social Advantage thus:-

"If, therefore, public finance is to be treated as a branch of science, economic or political, and not merely as a string of catchpenny maxims, one fundamental principle must lie at the root of it. This we may call the Principle of Maximum Social Advantage: Most of the operations of public finance resolve themselves into a series of transfers of purchasing power. These transfers are made by taxation or otherwise, from certain individuals to public authorities, and back again from these authorities, by way of public expenditure, to other individuals, some of whom, such as policemen or contractors, render services in return, while others, such as old age pensioners, do not.... As a result of these operations of public finance, changes take place in the amount and in the nature of the wealth

which is produced, and in the distribution of that wealth among individuals and classes. Are these changes in their aggregate effects socially advantageous? If so the operations are justified; if not, not. The best system of public finance is that which secures the maximum social advantage from the operations which it conducts. This principle is obvious, simple and far-reaching, though its practical application is often very difficult.

In seeking to apply this principle we need to have before us certain tests of social advantage. The first which suggests itself is the need to preserve the community, assuming it to be worth preserving in its existing form, against internal disorders and external attacks. How this should best be done falls outside the scope of this discussion. But it is a question of wise public policy at home and abroad, and not merely of expenditure on armaments and police ..... And, in any case, it is their business to try to increase the welfare, both economic and non-economic, of its members.

This brings us naturally to the more strictly economic tests of social advantage, with which this book is primarily concerned. The two chief conditions of an increase in the economic welfare of any community are, first, improvements in productive power, and second, improvements in the distribution of what is produced. Improvements in

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productive power resolve themselves into mere increases of productive power, so that a larger product per head of the population shall be obtained with a smaller effort, and improvements in the character of what is produced, so that a given amount of product shall go further in satisfying economic needs, and shall thus give rise to greater economic welfare. Improvements in distribution resolve themselves into a reduction in the great inequality, which is found in most civilized communities, in the incomes of different individuals and families and a reduction in the great variability, between different periods of time, of the incomes of particular individuals and families, especially among the poorer sections of the community.

It should be added that the statesman is a trustee for the future, no less than for the present. Individuals die, but the community, of which they form a part, lives on. The statesman, therefore, should prefer a larger social advantage in the future to a smaller one to-day".

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